85-568 (1)



No. 85-

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

*Appellants,*

*v.*

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
*et al.,*

*Appellees.*

On Appeal from the Supreme Court
of North Carolina

## JURISDICTIONAL STATEMENT

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## QUESTIONS PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission ("FERC") has exclusive jurisdiction to regulate wholesale electric rates and to allocate wholesale power supplies and their costs among different States. This case presents two closely-related questions involving the power of state regulatory commissions to nullify FERC's regulation and otherwise to burden the transmission and wholesale sale of electric power across state lines:

1. Whether the Federal Power Act permits a state regulatory commission, in setting retail rates within the state's borders, to reject the interstate wholesale cost and power allocations that FERC regulates and, in this case, actually approved?

2. Whether the Commerce Clause permits a state regulatory commission to give its citizens a "first call" preference on the inexpensive hydroelectric power generated in a multistate area?

## PARTIES BELOW

The appellants in the North Carolina Supreme Court were Nantahala Power and Light Company, Tapoco, Inc., and Aluminum Company of America.

The appellees were State of North Carolina *ex rel.* Utilities Commission: Lacy H. Thornburg, Attorney General; Public Staff of the North Carolina Utilities Commission; Henry J. Truett; Town of Bryson City; Swain County Board of County Commissioners; Cherokee County; Graham County; Jackson County; Town of Andrews; Town of Dillsboro; Town of Robbinsville; Town of Sylva; Tribal Council of the Eastern Bank of Cherokee Indians; Muriel Maney; and Derol Crisp.

## RULE 28.1 STATEMENT

Appellants Nantahala Power and Light Company and Tapoco, Inc. are each wholly-owned subsidiaries of Aluminum Company of America ("Alcoa"). Alcoa has no parent company. The companies (other than wholly-owned subsidiaries) in which Alcoa has ownership interest are listed in a supplemental statement that appears in the Appendix to the Jurisdictional Statement (345a–353a).



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On Appeal from the Supreme Court of North Carolina

## JURISDICTIONAL STATEMENT

## OPINIONS BELOW

The opinion and judgment of the North Carolina Supreme Court (Appendix ("App.") 1a–138a) is reported at 313 N.C. 614 and 332 S.E.2d 397. The opinion of the North Carolina Court of Appeals (App. 141a–164a) is reported at 65 N.C. App. 198 and 309 S.E.2d 473. The opinions of the North Carolina Utilities Commission, dated September 2, 1981 (App. 165a–235a), and January 28, 1982 (App. 236a–247a) are unreported. In addition, the pertinent portions of the following decisions of FERC that were issued in a parallel proceeding are reproduced in the Appendix: the FERC decision asserting jurisdiction over the allocation contract (App. 262a–266a), which is reported at 13 FERC ¶ 61,192 (CCH); the FERC Administrative Law Judge decision (App. 267a–282a), which is reported at 15 FERC ¶ 63,014 (CCH); FERC Opinion No. 139 (App. 283a–301a), which is reported at 19 FERC ¶ 61,152 (CCH); and FERC Opinion No. 139-A (App. 302a–313a), which is reported at 20 FERC ¶ 61,430 (CCH).

## JURISDICTION

The final judgment of the North Carolina Supreme Court was entered on July 3, 1985. Nantahala's Notice of Appeal (App. 315a–316a) and Alcoa's Notice of Appeal (App. 317a) were each filed in the Supreme Court of North Carolina on July 23, 1985. Tapoco's Notice of Appeal (App. 318a) was filed on September 23, 1985. This Court has jurisdiction under 28 U.S.C. § 1257 (2). See *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983).[1]

## CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . ."

The United States Constitution, Article I, Section 8, Clause 3: "The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 791a–828c, and of the North Carolina Public Utilities Act, N.C. Gen. Stat. §§ 62-1, *et seq.*, are reprinted at App. 248a–261a.

[1]In the case on appeal, the North Carolina Supreme Court held that the North Carolina Utilities Commission's investigation and disapproval of FERC-regulated wholesale cost allocations and determinations was required by a North Carolina statute (see App. 77a–80a) and rejected appellants' claims that such applications of this statute are preempted by federal law and contrary to the Commerce Clause. Further, state ratemaking orders, issued under delegated legislative authority, are themselves "state statutes" for purposes of 28 U.S.C. § 1257(2). See, *e.g.*, *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983); *Sultan Ry. & Timber Co.* v. *Department of Labor and Indus.*, 277 U.S. 135, 136 (1928); *Lake Erie & Western Ry. Co.* v. *State Pub. Utils. Comm'n*, 249 U.S. 422, 424 (1919).



## STATEMENT OF THE CASE

### Introduction

In the country today, wholesale electric power is commonly produced from different sources and then transmitted across multi-state service areas to local electric utilities that serve different States. Because this power has varying production costs, these arrangements inevitably produce controversies between States over how wholesale power supplies and their costs should be allocated. Each affected State would like to have as much as possible of the power that is inexpensive to produce and as little as possible of the high cost power.

Congress has granted FERC exclusive jurisdiction over these multi-state wholesale power and cost allocations and the resulting wholesale rates and costs. See App. 251a–257a. FERC's regulation thus determines the "wholesale costs" that each local utility incurs in obtaining power "for resale" to its customers.

This case presents a multi-state dispute over how wholesale power and its costs should be allocated and a square challenge to FERC's exclusive jurisdiction over these determinations.

Here, two different Alcoa subsidiaries sell electricity in two different States. Nantahala Power and Light Company ("Nantahala") serves retail customers and three wholesale customers in North Carolina. Tapoco, Inc. ("Tapoco") exclusively serves an Alcoa aluminum plant in Tennessee. Nantahala and Tapoco/Alcoa each has an inexpensive hydroelectric source of power as well as a supplemental expensive source of power, which costs about three times more. The allocation of the inexpensive power between the two companies and the two States is prescribed by wholesale rate schedules filed with FERC. FERC further has conducted extensive proceedings and approved allocations of the inexpensive power and its corresponding costs between Nantahala's North Carolina load and Tapoco's Tennessee load. The North Carolina Attorney General participated

in these FERC proceedings on behalf of Nantahala's retail customers.

However, in a separate proceeding in which North Carolina set Nantahala's retail rates, North Carolina refused to allow recovery of the wholesale costs allocated to Nantahala by the FERC rate schedules and power supply arrangements. Instead, North Carolina reallocated the economic benefits of the inexpensive power between the States and gave North Carolina customers a preference to this low cost hydroelectric power. North Carolina further ordered Tapoco's Tennessee customer (Alcoa) to pay a $29 million "refund" to Nantahala's customers in North Carolina.

The North Carolina Supreme Court here held that a state commission, in setting retail electric rates, has the discretion to disregard FERC-regulated and FERC-approved power and cost allocations and to refuse to allow recovery of the "wholesale costs" allocated to that State under the Federal Power Act. This decision conflicts with the holdings of numerous state supreme courts that, under this Court's "filed rate" doctrine, state commissions are bound by these FERC wholesale cost determinations and required to treat them as "reasonable operating expenses" attributable to intrastate retail service. *E.g., Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32, 38 (N.D. 1981); *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358, 1363 (1977), *cert. denied*, 435 U.S. 972 (1978); see pp. 14–20, *infra*. The North Carolina holding also conflicts with the recent Commerce Clause holding of the Eighth Circuit in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, Nos. 84-2409, 84-2410, and 84-2480 (8th Cir., filed Aug. 23, 1985)[2], as well as this Court's decision in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982).

**1. Background: The New Fontana Agreement And 1971 Apportionment Agreement.** Nantahala, Tapoco, and the Tennessee Valley Authority ("TVA") are each engaged in the generation of hydroelectric power on the Little Tennessee River and its tributaries. Nantahala owns a number of plants in North Carolina. Tapoco owns two plants in Tennessee and two plants in North Carolina.[3]

[2]Because the Eighth Circuit decision has not yet been reported, it is reproduced at pp. 319a–344a of the Appendix.



In 1962, TVA, Nantahala, Tapoco, and Alcoa entered into what has been called the New Fontana Agreement (sometimes referred to as "NFA"). It provides that Nantahala and Tapoco would coordinate their electric production with the TVA system. App. 14a–15a, 28a–29a. Under this agreement, TVA controls the generation of power at Nantahala's and Tapoco's facilities, with all this electricity then delivered to TVA and dispatched over TVA's interstate system. In return, Nantahala and Tapoco collectively receive fixed entitlements to electric power, which consist of both "capacity entitlements" (in megawatts ("mW"))[4] and "energy entitlements" (in kilowat-hours ("kWh")).[5] See App. 14a–15a; 28a–29a; 216a. Because Nantahala and Tapoco trade their actual generation, which varies substantially with stream flow, for more consistently available TVA power, the TVA entitlements are less than Nantahala's and Tapoco's actual generation of electricity.

A 1971 Apportionment Agreement prescribes how the TVA entitlement power is divided between Nantahala and Tapoco.[6]

[3]Tapoco has a license under Part I of the Federal Power Act to operate its plants to supply power to the Alcoa aluminum plant in Alcoa, Tennessee. App. 272a–273a. Nantahala serves public customers, all of whom are located in western North Carolina. App. 273a.

[4]Capacity entitlements determine the amounts that Nantahala and Tapoco/Alcoa pay for peaking power. That is, the companies incur far greater costs per megawatt for the difference between (1) their peak demands (the particular hour and day when their consumptions are the highest) and (2) their capacity entitlements. See App. 28a, 31a.

[5]Energy entitlements determine the total amounts of energy that the two firms may obtain annually from TVA under the contracts. See App. 28a, 31a.

[6]Prior to 1971, Alcoa also purchased power from Nantahala, under a 1963 agreement that effectively defined Nantahala's share of the entitlements. App. 30a.

The New Fontana Agreement and 1971 Apportionment Agreement are interstate wholesale power exchange agreements and the arrangements under which Nantahala and Tapoco obtain power "for resale." The agreements are subject to FERC's jurisdiction under Part II of the Federal Power Act. See App. 262a–266a; see also App. 72a. FERC has denominated the New Fontana and 1971 Apportionment Agreements as Nantahala's FERC Wholesale Rate Schedule No. 1.[7] App. 72a.

Between 1962 and 1971, Nantahala's entitlements were sufficient to serve all the needs of Nantahala's public customers. App. 30a. However, the demand for electricity in western North Carolina has steadily increased and, in 1971, Nantahala began to purchase additional, more expensive power from TVA. By 1975, this additional expensive power cost 18.5 mils per kWh (App. 32a)—or more than three times the cost per kWh of the entitlement power (which is less than 6 mils per kWh). See Ex. RDB-R2; Tr. V.3 p. 3.[8]

In 1976, Nantahala sought to increase its rates. It filed a request with FERC to increase its charges to its three wholesale customers and a separate request with the North Carolina Utilities Commission to increase its charges to its retail customers. App. 7a, 269a. A common fact underlying both proceedings is that Nantahala's costs of obtaining power for resale to both its wholesale and its retail customers in North Carolina are determined by the FERC-regulated New Fontana and 1971 Apportionment Agreements. Nantahala's wholesale and retail customers thus each asserted claims that these agreements were unfair, that they should be modified or disregarded, and that greater

[7]These are also denominated Tapoco FERC Wholesale Rate Schedule No. 3. App. 72a, 263a.

[8]Nantahala bears its own costs of generation under the NFA. Thus, the unit cost of the entitlement power is determined by dividing Nantahala's costs of operating its generating facilities by the volume of the entitlement power allocated to Nantahala. In contrast, Nantahala pays for the power purchased from TVA.



amounts of inexpensive power should be allocated to North Carolina. However, these basic issues were considered by two tribunals: FERC, which has jurisdiction to consider them, and the North Carolina Utilities Commission, which does not. The two tribunals reached very different results.

**2. The FERC Proceedings.** In 1978, Nantahala's wholesale customers filed a formal complaint with FERC under Section 306 of the Federal Power Act. (See App. 257a). This complaint sought to set aside or modify the New Fontana and 1971 Apportionment Agreements under the provisions of Section 206 of the Act (See App. 256a–257a). The North Carolina Attorney General intervened in this FERC complaint proceeding on behalf of Nantahala's retail customers, and he participated fully in it.[9]

The retail and wholesale customers contended that Alcoa had manipulated the terms of the New Fontana Agreement and 1971 Apportionment Agreement to benefit Alcoa's aluminum production operations in Tennessee at the expense of Nantahala's North Carolina customers. After a five week evidentiary hearing before an Administrative Law Judge in which all the transactions among affiliates were carefully scrutinized (App. 267a–282a), FERC considered and rejected most of the North Carolina customers' claims.

FERC rejected the claims that the New Fontana Agreement was unfair to Nantahala and had improperly traded off the needs of Nantahala's wholesale and retail customers in North Carolina to benefit Alcoa's plant in Alcoa, Tennessee. App. 293a–295a. FERC found that there was "no intent [in the New Fontana Agreement] to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." App. 295a. It thus treated this agreement as establishing the en-

[9]The complaint proceeding was consolidated with Nantahala's separate 1976 request for an increase in the rates to its three wholesale customers. See p. 6, *supra*.

titlements to inexpensive power which Nantahala and Tapoco could divide. FERC also rejected the claims that Alcoa "used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act" and that the two entities operated as a single integrated system. App. 291a.

FERC approved the 1971 Apportionment Agreement's allocation of 54.3 mW of capacity to Nantahala. App. 297a. However, FERC concluded that Nantahala should have received an additional 44 million kWh in energy entitlements. App. 297a. FERC then affirmed the Administrative Law Judge's conclusion that the "just and reasonable rates and charges are those which are in conformity with the findings and conclusions set forth in [its] decision." App. 282a; see App. 301a.

Nantahala's retail customers, again represented by the North Carolina Attorney General, and Nantahala's wholesale customers each appealed these FERC determinations to the United States Court of Appeals for the Fourth Circuit. The Fourth Circuit affirmed FERC. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

**3. The NCUC Proceedings.** In the retail rate case, the North Carolina Utilities Commission ("NCUC") had initially agreed that Nantahala's costs of obtaining power for resale were determined by the FERC-regulated rate schedules and power supply agreements. However, in 1980, the North Carolina Supreme Court remanded Nantahala's rate case to the NCUC to consider whether the contractual arrangements are "in the best interests of the customers of Nantahala." *North Carolina ex rel. Utilities Commission.* v. *Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980). The North Carolina Supreme Court further stated that Nantahala's "public customers . . . have, in effect, 'first claim' on all energy actually generated by Nantahala's facilities." 299 N.C. at 438, 263 S.E.2d at 588. On remand, in 1981, the



NCUC proceeded to consider the very cost and power allocation issues that were then being litigated before FERC.[10]

The NCUC responded to the North Carolina Supreme Court's instruction to promote the "best interests" of Nantahala's North Carolina customers by rejecting the allocation of the inexpensive power prescribed by the FERC-regulated agreements and reallocating the economic benefit of this power as if the FERC-regulated New Fontana and 1971 Apportionment Agreements did not exist.[11] Instead, the NCUC adopted a method that it described as a "first call" preference for "North Carolina['s] public load [to] the total electric energy output of the combined system," with only the "excess [to] be available for sale [to] Alcoa" in Tennessee. App. 183a; see also App. 240a. The NCUC acknowledged that it effectively rescinded the FERC-regulated agreements by stating that its action was "nicely suited as a proper alternative to reformation of the [FERC-regulated] contracts." App. 202a.

The NCUC's "first call" preference for North Carolina gives Nantahala a proportionately higher and ever-increasing percentage of the economic benefits from the hydroelectric power that

[10]Alcoa and Tapoco filed suit in federal district court on January 25, 1982 (prior to the final NCUC decision) seeking to enjoin threatened NCUC action on the ground that it interfered with the operation of the Federal Power Act and impermissibly burdened interstate commerce. The District Court and Fourth Circuit held that abstention principles precluded the District Court from adjudicating these claims. See *Aluminum Company of America* v. *Utilities Comm'n*, 713 F 2d 1024, 1028-30 (4th Cir. 1983). This Court denied Alcoa's petition for *certiorari* with Justices Brennan and White noting that they would have granted the petition. 104 S. Ct. 1326 (1984).

[11]Indeed, the NCUC disregarded the NFA on the basis of the NCUC's explicit finding that the NFA "is structured to meet Alcoa's demand" in Tennessee rather than the needs of the North Carolina public load. App. 197a. This was contrary to the Administrative Law Judge's earlier finding that the NFA is fair to both States (see App. 275a), which FERC would affirm four months after the NCUC's order was entered. See pp. 7-8, *supra*; App. 293a-295a.

Nantahala's and Tapoco's facilities generate.[12] This preference has three interrelated aspects. First, the NCUC combined or "rolled-in" the companies' power supplies and costs, but excluded the expensive power that Alcoa purchased from TVA.[13] App. 211a. Second, the NCUC used Nantahala's total (and ever-increasing) demand for power—not Nantahala's contribution to the low-cost power supply—to determine Nantahala's percentage share of the cheap power.[14] Third, and most significant of all, Nantahala's total share of the power is determined by applying Nantahala's assumed percentage share—and only Nantahala's—not to Nantahala's and Tapoco's entitlements under the New Fontana Agreement, but rather to hypothetical larger amounts that include electricity that is not available to either Tapoco or Nan-

[12]The Intervenor witness who advocated this approach testified that, under his projections for the growth in Nantahala's demand, there would be no inexpensive power left for Tennessee within 8 years. Tr. V.7, pp. 38-39.

[13]Tapoco/Alcoa and Nantahala together have four sources of power. Two of them are low-cost and two are not. They are: 1) Nantahala's entitlements from TVA, 2) Tapoco's entitlements from TVA, 3) Nantahala's purchases from TVA, and 4) Alcoa's purchases from TVA delivered to it by Tapoco. The Commission "rolled-in" only the first three. It left out Alcoa's expensive purchases from TVA (App. 211a, see App. 66a) and thereby assured that North Carolina's share of the low cost power would be inflated.

Because Alcoa's average cost of power (*i.e.*, entitlements plus separate power purchased from TVA) is higher than Nantahala's (see Tr. V. 14, p. 70), a complete roll-in of Nantahala and Tapoco into a single hypothetical combined system would have increased the average cost of power resold in North Carolina and disadvantaged North Carolina's customers. See App. 66a.

[14]NCUC determined Nantahala's capacity allocation by dividing *its peak load requirements* in the given test year (there, 105.7 mW) by the sum of the total generating capability of Nantahala and Tapoco and the additional capacity that Nantahala purchased from TVA in that year. See App. 219a-220a; see also App. 68a. This percentage share bears no relationship to the proportionate contribution that Nantahala's generation makes to TVA entitlements under the NFA. Therefore, as Nantahala's peak load requirements increase in future years—as they have—so too will its percentage of the inexpensive capacity entitlements—as it has in subsequent Nantahala rate cases. See p. 11, n.16, *infra*.



tahala under the NFA.[15] Because Tennessee receives only the remaining power (see App. 220a-221a; see also App. 68a-69a), this formula sets rates on the basis of an absolute preference for North Carolina to the inexpensive power. Indeed, because NCUC treated Nantahala as entitled to ever-increasing percentages of both Nantahala's and Tapoco's power, the NCUC preference extends to hydroelectric power generated in Tennessee as well as power generated in North Carolina.

As the North Carolina Supreme Court stated, the "practical effect" of the NCUC Order is that Nantahala was barred from recovering all of the wholesale costs "associated with" the FERC-regulated NFA and 1971 Apportionment Agreement. See App. 69a. Specifically, the NCUC set rates on the basis of an entirely different allocation of the inexpensive power and the related wholesale costs than under the FERC-regulated and FERC-approved rate schedules. Whereas those schedules allocate 54.3 mW of capacity entitlements to Nantahala and its public customers in North Carolina, the NCUC allocated them 92.7 mW (24.6% of 376.9 mW) of low cost capacity in the 1975 "test year" (App. 219a-220a), with this allocation to increase in future test years.[16] The NCUC also allocated more inexpensive energy to Nantahala than had FERC. Compare App. 220a-221a with App. 297a. The NCUC thereby reduced Nantahala's assumed average wholesale cost of power far below the actual cost established by the FERC-regulated rate schedules. This, as stated by the North Carolina Supreme Court, resulted in a corresponding increase in

[15]Thus, the NCUC assumed that Nantahala and Tapoco had a total of 376.9 mW of inexpensive hydroelectric power (App. 219a), which is greatly in excess of the 218.3 mW in capacity entitlements provided by the NFA. See p. 5, *supra*.

[16]Indeed, in a subsequent rate case, the NCUC applied the same approach to allocate to North Carolina 100.1 mW of capacity. See *North Carolina ex rel. Util. Comm'n* v. *Nantahala Power and Light Co.*, No. 111A84 (S.Ct. N.C., filed Aug. 13, 1985). The greater allocations resulted from intervening increases in the demand and needs of the North Carolina customers. See p. 10, n.14, *supra*.

the costs "effectively allocated" to Tapoco and its customer in Tennessee. See App. 69a–70a.

As a result of this dramatic reduction in Nantahala's assumed wholesale unit costs, the NCUC ordered reductions in Nantahala's retail rates and a refund of some $29 million (including interest) to Nantahala's retail customers in North Carolina. See R. 380–81. Because this substantially exceeds Nantahala's net worth, the NCUC has ordered Alcoa,[17] as the "beneficiary" of the FERC-regulated agreements, to fund the refunds to the extent that Nantahala may not do so without impairing its capital.[18] App. 178a–179a. NCUC has, in short, ordered the Tennessee customer of Tapoco to refund money to Nantahala's North Carolina customers.

Not only is the ordered "refund" in excess of Nantahala's net worth, but the continuing application of the NCUC's method, which the North Carolina Supreme Court has essentially mandated in subsequent decisions,[19] has brought the current refund amount to approximately $45,000,000. These refunds and North Carolina's ongoing expropriations of the economic benefits of the Tapoco hydroelectric power endanger the continuation of aluminum production at Alcoa's Tennessee plant.

[17]Alcoa was involuntarily made a party to these NCUC proceedings in 1981, after the case was remanded to it by the North Carolina Supreme Court, on the theory that it is a North Carolina "public utility" and part of the "Alcoa system." App. 9a, 232a. No attempt was made to square this finding with the exclusion of Alcoa's purchased power from the hypothetical rolled-in system. See p. 10, n.13.

[18]Under the NCUC approach, Alcoa is required to pay for all the expensive TVA power purchased for its own needs and for approximately 75% of the expensive TVA power purchased by Nantahala to serve North Carolina's customers. See App. 220a–221a.

[19]*North Carolina ex rel Utils. Comm'n* v. *Nantahala Power and Light Co.*, No. 111A84 (S. Ct. N.C., filed Aug. 13, 1985); see also *North Carolina ex rel. Utils. Comm'n* v. *Edmisten*, No. 549A84 (S. Ct. N.C., filed Aug. 13, 1985).



**4. The North Carolina Supreme Court's Decision.** The North Carolina Supreme Court affirmed the NCUC order in a 132 page opinion. It rejected the appellants' arguments that the NCUC order invaded FERC's exclusive jurisdiction under the Federal Power Act (App. 73a–98a) and violated the Commerce Clause (App. 98a–106a).

First, the North Carolina Supreme Court reasoned that, despite the Federal Power Act, state commissions retained jurisdiction to investigate interstate wholesale power and cost allocations and "to do exactly what the [NCUC] has done in the instant case: determine that certain of a utility's [wholesale] costs were effectively incurred for the benefit of its shareholder, not its retail consumers," and disallow those wholesale costs. App. 84a. The North Carolina Supreme Court held that the application of the state statutes requiring such investigations and disallowances (App. 78; see N.C. Gen. Stat. § 62–133, App. 258a–261a) had not been preempted by the Federal Power Act.

Second, the North Carolina Supreme Court rejected the contentions that the NCUC order granted North Carolina citizens an economic preference, contrary to the Commerce Clause. The North Carolina Court asserted that its citizens did not have a true "first call" on the inexpensive power because the economic benefits of *all* the hydroelectric power had not been reserved to them, and the exportation of power, as such, had not been banned. It further held that the NCUC order had only an incidental effect on interstate commerce. App. 100a–102a, 105a.

The North Carolina Supreme Court refused to stay its order. App. 139a–140a. On July 31, 1985, the Chief Justice of the United States granted appellants' application for a stay, pending this Court's ruling on appellants' Jurisdictional Statement.

## THE QUESTIONS PRESENTED ARE SUBSTANTIAL

The North Carolina Supreme Court stated that "[t]his appeal raises substantial questions" under the Supremacy Clause and

the Commerce Clause of the Federal Constitution. App. 12a. This statement is correct. The North Carolina Supreme Court's holding that the Federal Power Act does not preempt a state utility commission's jurisdiction to investigate interstate power allocations and disallow wholesale costs required by FERC wholesale rate schedules, conflicts with this Court's "filed rate" doctrine and the holdings of state supreme courts, such as *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981), *Narragansett Electric Power Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1981), and their progeny. North Carolina's Commerce Clause holding further conflicts with the Eighth Circuit's recent decision in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission* (App. 319a-344a), as well as this Court's decision in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1981).

Resolution of these conflicts is a matter of great national importance. Contractual arrangements in which wholesale electric power is transferred to the interstate grid from different sources (with different costs) and then resold in different States are very common; they are the rule, not the exception. State commissions, like the NCUC, are increasingly attempting to impose a wholesale "rate structure" and an allocation of costs between States that will "benefi[t] its residents to the detriment of its neighbors."[20] A decision by this Court will thus affect many cases. The issues should be resolved now. Many financial and planning decisions are being made in reliance on FERC's exclusive jurisdiction over these arrangements.

## I. THE FEDERAL POWER ACT PREEMPTS NORTH CAROLINA'S APPLICATION OF ITS STATUTES.

In the Federal Power Act, Congress sought to assure that the transmission of electric power in interstate commerce and sales of

[20]*Massachusetts* v. *United States*, 729 F.2d 886, 888-89 (1st Cir. 1984); see *Middle South Energy, Inc.* v. *Arkansas Public Utils. Comm'n*, *supra*; see pp. 19-20 & n.29, *infra*.



power at wholesale would not be burdened by hostile or inconsistent state regulation. Congress recognized that exclusive federal jurisdiction over these arrangements is important to the national economy. It assures that state action will not impair interstate exchanges of power or impede the ability of suppliers of wholesale power to recover all the costs reasonably incurred in producing that power through wholesale rates. Congress thus gave the Federal Power Commission (now FERC) the exclusive jurisdiction to regulate the rates for sales of electric energy "for resale," to regulate the "transmission of electric energy in interstate commerce," and to allocate wholesale power supplies and their costs among different states and the local utilities serving them. See Section 201 of the Act, App. 251a; see also App. 249a–251a. The rate schedules filed with or approved by FERC, in turn, determine the "wholesale costs" that local utilities incur in obtaining power for resale in their respective States or service areas.

Here, the North Carolina Supreme Court has held that, despite these provisions, state regulatory commissions have essentially unlimited discretion, in setting retail rates, to disregard FERC's jurisdiction and determinations and to refuse to permit local utilities to recover all the costs incurred under FERC's wholesale rate schedules in their retail rates. Under North Carolina's holding, a local commission may do so whenever it finds, after an independent investigation, that interstate power supply arrangements are unreasonable or that the wholesale costs incurred under the rate schedules benefited customers in other states or the utilities' shareholders, and not local ratepayers. App. 84a–85a, 69a–70a. North Carolina's holding conflicts with the prior decisions of this Court and the decisions of many state supreme courts and federal courts of appeals.

This Court has held that the Federal Power Act (and the Natural Gas Act, 15 U.S.C. §§ 717–717w) preempt state commissions from regulating "directly" or "indirectly," the interstate wholesale rates and the cost and power allocations that are sub-

ject to FERC's jurisdiction. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 93–94 (1963); see *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964); *Maryland* v. *Louisiana*, 451 U.S. 725, 746–52 (1981) (state law preempted if its "effect" is to interfere with FERC's authority to regulate the proper allocation of costs). The Court established the "filed rate" doctrine to assure that provisions of state law may not have the effect of altering wholesale rates that are regulated or approved by FERC—as the NCUC order did here. As this Court stated in *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), state commissions and utilities alike:

> "can claim no rate as a legal right that is other than the filed rate, *whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms*. . . .
>
> [T]he right to a reasonable rate is the right to the rate which the [FERC] files or fixes and . . . the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."

*Id.* at 251–52 (emphasis supplied). Any departure from this principle would impair the Congressional objective of assuring the full recovery of all costs reasonably incurred in producing and distributing wholesale power in interstate commerce.[21] Thus, the Court has held that rates "filed with" or "fixed by" FERC must be treated as just and reasonable charges for all purposes and that neither state contract law nor other provisions of state law can be

[21]Indeed, these principles have special applicability here, where a State has attempted to reallocate power and its costs to benefit its own citizens. The Federal Power Act was enacted as a "direct result" of this Court's holding in *Public Utils. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), and its recognition that States could burden sales of power across state lines by allocating interstate wholesale costs to advance their "respective local interests." *Id.* at 89–90. See *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 378 (1983).



applied to subvert wholesale rate schedules thus established under FERC's jurisdiction. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578–80 (1981). As this Court has further stated:

> "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce . . . ."

*FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215–16 (1964).

North Carolina has crossed over this "bright line." The NCUC order effectively nullified FERC's cost and power allocations between North Carolina and Tennessee and modified the wholesale rate schedules that were regulated and approved by FERC.[22] To be sure, there was a factual dispute over the fairness of the New Fontana and 1971 Apportionment Agreements and, therefore, their appropriateness as power supply arrangements determining Nantahala's wholesale costs. But the purposes of the Federal Power Act require that this factual issue be resolved by a disinterested Federal agency, not an affected State, and that FERC engage in any balancing of the interests of customers in the respective States—as FERC here did. The filed rate doctrine preempted North Carolina from looking behind FERC's wholesale rate schedules. Thus, the fact that the NCUC made a factual finding that the agreements unfairly benefited Alcoa's Tennessee aluminum plant over North Carolina ratepayers is irrelevant. The state commission's jurisdiction to make this investigation is preempted by the Federal Power Act. Were the law otherwise, any state could thwart the objectives of the Federal Power Act at

[22]As the North Carolina Supreme Court stated, the "practical effect" of the NCUC order was that wholesale "costs" attributed to North Carolina's public load by the FERC wholesale rate schedules and "actually incurred by the unified system under the agreements were *effectively allocated* for ratemaking purposes to the systems' industrial customer" in Tennessee. App. 69a–70a (emphasis added).

will; a state commission can always find that some portion of wholesale costs should be shifted to customers in another State. These considerations are acute where, as here, FERC conducted extensive proceedings under Section 206 of the Act, made different findings, and expressly approved different interstate allocations of the power and wholesale costs. See pp. 7–8, *supra.*

State supreme courts and federal courts of appeals are almost uniformly in conflict with the North Carolina Supreme Court's holding. They hold that "[FERC] has exclusive jurisdiction over interstate wholesale rates,"[23] that the Federal Power Act preempts a State's jurisdiction over wholesale arrangements, and that "[s]tate and local commissions have no authority . . . to inquire into the reasonableness of wholesale rates, but must allow them as reasonable operating expenses" in setting retail rates[24]—as the NCUC refused to do here.[25] Similarly, these courts hold that state

[23]*Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 567, 381 A.2d 1358, 1362 (1977), *cert. denied*, 435 U.S. 972 (1978); *accord, Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32, 36–37 (N.D. 1981); *Northern States Power Co.* v. *Minnesota Pub. Serv. Comm'n*, 344 N.W.2d 374, 377-78 (Minn. 1984), *cert. denied*, 104 S. Ct. 3546 (1984).

[24]*Washington Gas Light Co.* v. *Public Serv. Comm'n*, 452 A.2d 375, 385–86 (D.C. App. 1982), *cert. denied*, 462 U.S. 1107 (1983); *accord, Public Serv. Co.* v. *Public Utils. Comm'n*, 644 P.2d 933, 939–40 (Colo. 1982); *City of Chicago* v. *Illinois Commerce Comm'n*, 13 Ill. 2d 607, 616 150 N.E.2d 776, 780–81 (1958).; *United Gas Corp.* v. *Mississippi Pub. Serv. Comm'n.*, 240 Miss. 405, 440–43, 127 So. 2d 404, 418–20 (1961).

[25]The conflict is thus not diminished in the slightest by the fact that some of these state supreme courts also have held that increases in FERC-regulated rates need not always *automatically* be passed through to consumers under fuel adjustment clauses. They reason that while the FERC-regulated wholesale costs must be treated as reasonable operating expenses and recovered, a state commission may find, in a general rate case, that increases in the wholesale rates were offset by savings in other aspects of the utility's business. *Compare Narragansett Elec. Co.* v. *Burke, supra*, 119 R.I. at 568, 381 A.2d at 1363, *with* App. 82a–84a. The decisive fact is that here the NCUC, in a general rate case, disallowed as operating expenses the wholesale costs and power supply arrangements for serving North Carolina customers that FERC approved. The NCUC did not find offsetting savings; nor could it.



commissions may not investigate FERC's underlying wholesale power and cost allocation determinations—as NCUC did here.[26] Finally, each decision conflicts with the North Carolina Supreme Court's conclusion that state commissions may disallow costs assigned to them by FERC's regulation whenever the state commission disagrees with FERC that the costs were incurred for the "benefit" of ratepayers in that state. *E.g., Washington Gas Light Co.* v. *Public Service Commission, supra,* 452 A.2d at 386.

These and other courts have held that where, as here, a state commission believes wholesale power and costs are being unreasonably allocated among different states, its *exclusive* remedy is to participate in FERC proceedings that seek relief under Section 206 of the Federal Power Act—as the North Carolina Attorney General did here—and thereby permit a neutral federal agency to balance the interests of the respective States and customers. *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1st Cir. 1984); see *Utah* v. *FERC*, 691 F.2d 444, 448 (10th Cir. 1982); *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, 593 F. Supp. 363, 366–67 (E.D. Ark. 1984), *aff'd on other grounds*, Nos. 84-2409, 84-2410, and 84-2480 (8th Cir.,

[26]See *Northern States Power Co.* v. *Minnesota Pub. Serv. Comm'n*, 344 N.W.2d 374, 381 (Minn. 1984), *cert. denied*, 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32, 38 (N.D. 1981); *Office of Public Counsellor* v. *Indiana & Michigan Elec. Co.*, 416 N.E.2d 161, 165 (Ind. App. 1981). The North Carolina Court's assertion that the two *Northern States* decisions allow a state commission to permit recovery of only that portion of the FERC-determined wholesale costs that the state commission finds benefit "intrastate retail customers" for ratemaking is wrong. App. 86a. On the contrary, *Northern States* squarely rejected that argument, reasoning that:

> "[I]t would frustrate the purpose of Congress in establishing reasonable wholesale rates if the reasonableness of these rates as an operating expense were inquired into by and made subject to the North Dakota PSC in establishing reasonable retail rates."

314 N.W.2d at 38. In short, there is no principled basis for distinguishing the *Northern States* decisions from this case.

filed Aug. 23, 1985), App. 319a–344a.[27] The state commission may not seek to nullify or modify the interstate wholesale cost and power allocations through any means, direct or indirect, and assuredly may not collaterally attack an explicit FERC determination made after a full hearing in which the State itself participated.

Although the North Carolina Supreme Court decision conflicts with each of the foregoing state and federal decisions, there is one lower court decision that may be consistent with North Carolina's position.[28] There is also a growing number of state utility commission decisions that follow North Carolina's approach.[29] Indeed, the growing uncertainty in this area of the law, *despite* this Court's decisions in *Montana-Dakota* and its progeny, accentuates the need for review of the Federal Power Act issue and makes it essential that this Court decide this issue now.

[27] In this respect as in others, this case is identical to the *Middle South Energy, Inc., supra,* though for reasons discussed below, the Eighth Circuit Court of Appeals did not reach the preemption question. See p. 22, *infra.*

[28] *Pike County Light & Power Co.* v. *Pennsylvania Pub. Util. Comm'n,* 77 Pa. Commw. Ct. 268, 465 A.2d 735 (1983); compare *Appeal of Sinclair Machine Prods., Inc.,* No. 84-380 (S.Ct. N.H., filed July 26, 1985).

[29] See, *e.g., Mississippi Power and Light Co.,* P.S.C. Miss. Case No. U-4620, Final Order on Rehearing (Sept. 16, 1985) (state commission partial disallowance of costs incurred under FERC-regulated rate schedules); *Louisiana Power & Light Co.,* L.P.S.C. Order No. U-16513-A (Sept. 13, 1985) (state commission denial of pass through of costs incurred under FERC-established power purchase cost allocation); *New Orleans Pub. Serv. Inc.,* City of New Orleans Council, Resolution R-85-526 (Sept. 5, 1985) (city council partial disallowance of costs incurred under FERC-established power purchase cost allocation); *Appalachian Power Co.,* P.S.C. W. Va. Case No. 83-697-E-42T, Order (Dec. 28, 1984) (state commission disallowance of pass through of costs incurred under FERC-regulated transmission agreement, pending separate state review and approval); *General Adjustment in Electric Rates of Kentucky Power Co.,* Ky. P.S.C. Case No. 9061, Opinion and Order (Dec. 4, 1984) (state commission restriction of incurrence of costs under FERC-regulated interstate transmission agreements).



## II. THE NCUC DECISION VIOLATES THE COMMERCE CLAUSE.

Even apart from the Federal Power Act, the NCUC order violates the Commerce Clause. Indeed, this aspect of the North Carolina Supreme Court's decision squarely conflicts with the Eighth Circuit's recent decision in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission* (8th Cir., filed Aug. 23, 1985) (App. 319a–344a), and with this Court's decision in *New England Power Co. v. New Hampshire,* 455 U.S. 331 (1982).

The NCUC order gives North Carolina customers a disproportionate and ever-increasing preference to the economic benefits of inexpensive hydroelectric power generated in Tennessee and North Carolina. See pp. [illegible], *supra.* The NCUC has also required Tapoco's Tennessee customer to pay "refunds" equivalent to the higher cost of power it has allocated to Tennessee. The order thereby explicitly transfers economic benefits from Alcoa's plant in Tennessee to Nantahala's North Carolina customers and inhibits the exportation of hydroelectric power generated in North Carolina to Tennessee.

This is the kind of direct burden on interstate commerce that has been held to be almost *per se* invalid. *New England Power Co.* v. *New Hampshire, supra* 455 U.S. at 338–39; *Public Utilities Commission* v. *Attleboro Steam & Electric Co.,* 273 U.S. 83 (1927); *cf. Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission,* 461 U.S. 375, 394 (1983) (Commerce Clause challenge rejected where affected sales were intrastate). Further, by giving North Carolina customers the equivalent of a preference on power generated in Tennessee and requiring payments from a Tennessee customer, North Carolina has engaged in the extra-territorial regulation of commerce that, too, has been held invalid. See *Edgar* v. *MITE Corp.,* 457 U.S. 624, 640 (1982) (plurality opinion). In all events, the fact that the NCUC order burdens the movement of things of value across state lines precludes the North Carolina Court's attempt to characterize the burdens on commerce as "incidental." See App. 105a.

Furthermore, the basis of the NCUC decision was that it was required, by the North Carolina Supreme Court's earlier mandate, to adopt this allocation if it was in the "best interests" of *North Carolina's* customers and to give those North Carolina customers the equivalent of a "first call" preference on hydroelectric power generated in that State. See pp. 8-9, *supra.* The NCUC fully implemented this mandate by making the reservation of economic benefits for North Carolina customers the test of the "proper" allocation of the inexpensive power and giving North Carolina customers preference to the power generated in Tennessee as well as in North Carolina. See pp. 9-12, *supra.* In short, the purpose as well as the effect of the NCUC's order was to preserve the benefits of inexpensive power for Nantahala's North Carolina customers, regardless of the interests of Tennessee. This constitutes precisely the kind of economic protectionism that is virtually *per se* unconstitutional under the Commerce Clause. *Philadelphia* v. *New Jersey*, 437 U.S. 617, 624, 628 (1978).

Like the instant case, the Eighth Circuit's recent decision in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission, supra,* involved a state commission proceeding that threatened to nullify certain FERC-regulated wholesale power supply and cost allocations and effectively to reallocate those costs to benefit local ratepayers. Middle South is a holding company whose four subsidiaries provide electricity in several different states, including Arkansas. Another Middle South subsidiary has constructed a nuclear generating facility whose costs of power are higher than other Middle South companies' costs. As in the instant case, FERC has made an allocation of the power supply and the resulting wholesale costs among the States and respective utilities. And as in the instant case, Arkansas was attempting to impose a different allocation, under which Arkansas would be allocated none of the high cost power. App. 330a.

Because it wished to avoid a question (not presented here) under the Public Utility Holding Company Act, the Eighth Circuit did not decide the question whether the Federal Power Act preempted the state commission's assertion of jurisdiction. App. 330a–331a. Instead, the court held that the commission order violated the Commerce Clause because, like the NCUC order, the Arkansas commission order had the purpose or the effect of shifting cost burdens to citizens in other states and gaining "a preference for citizens in the regulating jurisdiction . . . at the expense of out-of-state customers." App. 341a. Contrary to the North Carolina Supreme Court's holding in this case, the Eighth Circuit held that the resulting burdens on the operation of the interstate grid is not incidental; but is a "direct and substantial burden on . . . commerce that is interstate in a most basic form." App. 341a.



*New England Power Co.* v. *New Hampshire, supra,* is also indistinguishable from the present case. There, as here, the New Hampshire Commission ordered that retail electric rates within New Hampshire be set as if the inexpensive hydroelectric power that had been exported to other states were consumed in New Hampshire, effectively preserving the benefits of New Hampshire power for New Hampshire residents. 455 U.S. at 336–37 n. 3 & 339. This Court held that this order, like the NCUC order, imposed a substantial burden on the transmission of power in interstate commerce and epitomized the protectionism that the Commerce Clause prohibits. 455 U.S. at 339. Because New Hampshire did not seek to prevent the physical exportation of power any more than North Carolina has, this case cannot be distinguished. Compare App. 100a–101a. Indeed, the instant case is more egregious than *New England Power* because the NCUC order gives North Carolina preferential benefits to hydroelectric power produced in Tennessee as well as to the power generated in North Carolina.

## CONCLUSION

The Court should note jurisdiction and set the case for full briefing and argument on the merits. The federal issues are too substantial, and have too large an impact on Tennessee and other States, for the North Carolina courts and regulators to be the only tribunals to consider them.

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